SENATE FINANCE & CLAIMS

Exhibit No. 6

Date 4-5-07

Bill No. HB 443 HB444

Testimony in Support of HB 443

Before the Senate Finance & Claims Committee
On Behalf of the Clark Fork River Basin Task Force
By Gerald Mueller
April 5, 2007

Chairwoman Schmidt, members of the committee, thank you for the opportunity to testify in support of HB 444. My name is Gerald Mueller. I live at 440 Evans in Missoula. My telephone number is 543-0026.

I testify on behalf of the Clark Fork River Basin Task Force. The Task Force was created in 2001 pursuant to a statute passed because of concerns about the security of the water rights in the Clark Fork River basin and about the basin water supply and management. The statute that created the Task Force directed it to write a watershed management plan for the entire Clark Fork River basin. The plan had to identify options for protecting the security of existing basin water rights and provide for the development and conservation of basin water in the future. The Task Force completed the plan, the *Clark Fork Basin Watershed Management Plan*, in September 2004 and presented it the Governor and the Legislature. Much of the *Plan* was subsequently adopted into the State Water Plan.

The *Plan* found that the basin does have a water supply problem. Lower basin hydropower water rights are filled only rarely. Avista's rights are filled at its Noxon Rapids Dam, which is located just upstream of the Montana-Idaho boarder, only 6-8% of the time on average. This appears to mean that 92-94% of the time, water is not legally available to support new appropriations anywhere in the basin. It also means that water uses based on water rights junior to Avista's are at risk to being interrupted by a water rights call. Some 7,800 water rights in the basin are junior to Avista's earliest 1951 water right. The *Plan's* finding was recently confirmed by a DNRC decision to deny a water right permit to the Thompson Falls cogeneration plant. The decision upheld a proposed DNRC hearings examiner conclusion which stated, in part, "The Applicant has not proven that water can reasonably be considered legally available..." because a lower basin hydropower utility's water right is expected to be filled only 16 to 24 days each year and thus the applicant would be subject to a water rights call on all other days.

The *Plan* considered the available alternatives for addressing this situation and concluded that the best one would involve use of water now stored in Hungry Horse, a federal reservoir located near the top of the basin on the South Fork of the Flathead River. Hungry Horse Reservoir was constructed and is operated by United States Bureau of Reclamation (BOR) "(f)or the purpose of irrigation and reclamation of arid lands, for controlling flood, improving navigation, regulating the flow of the South Fork of the Flathead River, for the generation of electric energy and for other beneficial uses primarily in the State of Montana, but also for downstream uses." In its water rights filing with the Montana Water Court, USBR claimed 3.5 million acre-feet of storage for future sales. To date, no contracts have been issued for this water. The *Plan* proposes that the state contract with BOR for a block of Hungry Horse water and then lease this water to Clark Fork River basin water users to support to new uses and to protect junior users from water rights calls by lower basin hydropower users.

In 2005, at the request of the Task Force, the legislature passed HJ3 which urged the Montana Department of Natural Resources and Conservation (DNRC) to enter into negotiations with BOR

to "...determine the availability and cost of water stored behind Hungry Horse Dam for which the State of Montana might contract to support existing water use and future water development in the Clark Fork River basin." In September 2006, DNRC met with the Regional Director of BOR, Bill MacDonald to discuss the negotiation process. At that meeting, Mr. MacDonald indicated that he did not see contracting with the state as a problem, but the "devil will be in the details." He stated that the state could contract for an amount of water larger than it would immediately need, in effect reserving water in the reservoir for future use. He also said that the state would not need to pay for the water until it would actually be used.

As a follow-up to this meeting, DNRC Director Mary Sexton wrote to Mr. MacDonald asking for the estimated cost and time requirements for completing a contract for Hungry Horse water for potential annual contracted volumes between 50,000 and 250,000 acre-feet in increments of 50,000 acre-feet. On December 6, 2007, Mr. MacDonald replied with the requested information. A copy of this letter is attached with this testimony.

Depending on whether any of the steps can be taken simultaneously, BOR's estimate of the total time and cost to complete the contract is on the order of 3 - 5 years and $3 million. The applicant must pay for the contracting processing costs not covered by the federal government.

The first step in the process is a reallocation study of the remaining Hungry Horse project costs to three new water uses, municipal, industrial, and irrigation, in addition to the two existing purposes, hydropower and flood control. The BOR estimates that this step would cost $260,000 and take 1.5 years to complete.

No money is currently included in the Governor's budget to pay for any of the contracting process. Because the information only became available on December 6, 2007, it could not be considered in the budget process. The Task Force, therefore, requested a bill to provide $260,000 to DNRC to pay for the first contracting step, and we are grateful to Rep. Taylor for sponsoring the bill.

The Task Force opted not to wait two years for another budget cycle, because downstream states are moving to divert additional water from the Columbia River. At the direction from its 2006 legislature, the State of Washington is moving ahead to divert an additional 1 million acre-feet of water from the Columbia River. While such an allocation may not come directly from Hungry Horse reservoir, it would likely impact the operation of the system of dams in the Columbia River basin, including both Hungry Horse and Libby reservoirs in Montana. Hungry Horse and Libby and Lake Roosevelt behind Grand Coulee Dam provide the storage in the US that allows control of the flows of the Columbia River. The operational impact may have the effect of limiting the amount of water available in Hungry Horse for which the State of Montana might contract. Other downstream states may also act to divert additional Columbia River basin water. The Columbia basin states do not have an equitable apportionment of Columbia water, an interstate compact, or other vehicle for coordinating Columbia water allocations.

Contracting for Hungry Horse water is the most straight forward method Montana can use to reserve water for Montana water users. The longer we wait to complete this contract, the less water will likely be available for Montana water users.

The Clark Fork River basin is one of the fastest growing areas in the state. This growth will require additional water. The question is not whether the water will be supplied, but how it will

be supplied. Use of Hungry Horse storage can provide for the growth within the prior appropriation allocation system. Some day, the buying and selling of water rights might also be a viable alternative for meeting new water demands within the prior appropriation system. However, until the adjudication is completed, the validity of many existing water rights is an open question. Without invalidating, subordinating and/or purchasing the existing hydropower water rights, the Task Force does not see a viable alternative to a Hungry Horse contract and state leases that can provide for new water uses and protect existing water rights.

We urge this committee to provide the $260,000 to DNRC so the state can begin the contracting process now.

Thank you.

United States Department of the Interior

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DEC 6, 2006

Ms. Mary Sexton
Director
Department of Natural Resources and Conservation
State of Montana
P.O Box 201601
Helena, Montana 59620-1601

Subject: Hungry Horse Reservoir, Future Contracting Opportunities

Dear Ms. Sexton:

The Following information is provided in response to your letter of October 17, 2006, concerning the above subject wherein you requested estimates of the expected costs and schedules for each of the various processes required to obtain water from Hungry Horse Reservoir, as well as estimates of the likely cost of water for municipal and industrial and irrigation uses. You also requested information about the Bureau of Reclamation charges for municipal and industrial water from other Reclamation storage projects in the basin.

While we have tried to be as responsive to your request as possible given the information we currently have, please understand the ultimate cost, and time frames identified for each of the activities could vary greatly depending on the specific circumstances involved.

In looking at contracting for water from Hungry Horse Reservoir, there appears to be seven key areas that will require the most time and resources to complete. These are: (1) completion of a revised cost allocation, (2) completion of land classification studies if irrigation water is involved, (3) completion of an ability-to-pay study if irrigation water is involved, (4) completion of environmental compliance activities, (5) completion of a water needs assessment, (6) obtaining the required approval to enter into new contracts, and (7) preparation and negotiation of the contracts. All of these activities are discussed in further details below. Please understand that actions for many of the activities identified would be occurring simultaneously, as opposed to sequentially.

Key Areas for the Subject Contracts:
Concerning the cost reallocation, it appears that we would basically have to start at "ground zero" as we would be allocating to two purposes that have previously not had costs allocated to them.

This would require gathering of construction cost data (as built) and calculation of benefits for each purpose (i.e., power, flood control, irrigation, municipal, industrial, fish and wildlife, recreation, etc.) under the new operation criteria. We would also need engineering cost estimates correlated with actual as-built project costs for single purpose projects for flood control, irrigation, power, recreation, etc., as well as multi-purpose projects without each of those purposes. This will also require associated hydrologic studies and estimates of operation and maintenance costs. It is a complex process that necessitates a considerable amount of coordination between involved Federal and state agencies. The revised cost allocation would also require Congressional approval. With that information, we estimate the time and costs for economic and engineering work is approximately 300 staff days over a period of 1.5 years at an estimated cost of $260,000.

With respect to land classification studies, a great deal depends on the number of acres involved. The following represents estimates for three acreage ranges: (1) 500 through 5,000 acres, $9 per acre plus $5-8,000 for an economic analysis with an estimated completion time of 4 months, (2) 5,000 through 10,000 acres, $6 per acre plus $5-8,000 for an economic analysis with an estimated completion time 6 months, and (3) over 10,000 acres, $5 per acre plus $5-8,000 for an economic analysis with an estimated completion time of 8 months.

Reclamation would be required to complete an ability-to-pay study if irrigation water is involved. This analysis is not needed for municipal and industrial water supplies. Depending on the total acreage involved, we estimate it would take approximately 240 hours to complete the analysis with an estimated cost of $25,000.

As the process proceeds, Reclamation would initiate National Environmental Policy Act (NEPA) and Endangered Species Act (ESA) compliance activities. Given the volumes of water involved, we anticipate that an Environmental Impact Statement (EIS) would be required. NEPA compliance activities would include necessary public scoping meetings and hearings, Fish and Wildlife Coordination Act and cultural resource consultations, and consultations with Tribes on Indian trust assets. ESA activities would include consultation with National Marine Fisheries Service and U.S. Fish and Wildlife Service. We estimate that it would take 2-4 years to complete an EIS at an estimated cost of $1-2 million.

Reclamation with participation from the contractor(s) would initiate a water needs assessment study (including possible mitigation water, modeling. etc.) to identify the needs of the contractor(s). This information would also be used for NEPA/ESA compliance activities. We estimate it would take us approximately 40 hours to complete this activity at an estimated cost of $2,600.

Nearing completion of the above activities, Reclamation would begin the internal process to request approval from the Commission of Reclamation to negotiate and execute new contract(s). Items that must be addressed in such a request include, but are not limited to: identification of contractor, authority to contract, contractor's need for water and proposed use, quantity of water requested, compliance with NEPA and public participation requirements, explanation of water rate calculation, cropping information, water conservation measures, term of contract, operation and maintenance responsibility, etc. We estimated that it would take 40 hours at an estimated cost of $2,600.

Assuming we receive the required approval to proceed with the new contract(s), the following activities would be required: preparation of draft contracts, contract negotiation meetings, public participation requirements, etc. We estimated it would take us approximately 50 hours to prepare the draft contract and execution documents at an estimated cost of $3,250. This does not include any potential negotiation time over specific contract provisions or time associated with public meetings.

It should be noted that the above information does not address activities that are the contractor's responsibility (e.g., landholder election, court confirmation, etc.). Additionally, please be aware the contractor(s) have an opportunity to reduce their payments to Reclamation based on their level of participation for the various activities (e.g., providing requested information in a timely manner us opposed to Reclamation gathering information independently).

As indicated during the meeting on September 25, 2006, Reclamation's costs associated with the above activities are considered reimbursable. Consequently, if the decision is made to proceed, Reclamation would prepare a written cost agreement(s) to cover the estimated costs of the proposed action(s) to be reviewed and executed with the respective contractor(s) prior to Reclamation taking additional action. We estimate that it would take us approximately 16 hours to prepare the subject cost agreement(s) at an estimated cost of $1,040. This does not include any potential negotiation time over specific provisions of

the agreement. The cost agreement would most likely contain provisions for quarterly activity reporting as well as specific reimbursement/billing criteria.

Upon receipt of the executed cost agreement(s) and required advance payment(s), Reclamation would proceed with the contracting parties. The advance payment would be held in a special account established for the contractor located in Reclamation's books and applied towards the United States' costs.

With respect to your request for estimated rates for municipal and industrial and irrigation uses from Hungry Horse Reservoir, absent a revised cost allocation and available local market rate information we are not in a position to provide this information at this time. Current charges for municipal and industrial water supplies from other Reclamation storage projects in the region range from approximately $28-78 per square-foot, which do not include any additional charges that may be imposed by irrigation districts involved with the subject water deliveries.

Hopefully you will find the above information helpful in the decision making process. As you can see, it appears that this process could take several years to complete. Please understand the above represents Reclamation's best estimate, as this is a complex process composed of a myriad of variables which are difficult to predict with any certainty at this time.

As indicated during the September meeting, additional staff-to-staff discussions are most likely warranted to assist with the State's decision making process. Please feel free to contact Mr. Ryan Patterson at 208-378-5340 if you have any questions.

Sincerely,

J. William McDonald
Regional Director